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AGENDA ITEM 8a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Permissible Equity Market Investment Analysis Update, including ADRs and GDRs Analysis
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information only.
- IV. ANALYSIS**

Attached is Wilshire Associates' Update on the Permissible Equity Market Analysis. As required in CalPERS' Permissible Equity Policy for Emerging Equity Markets, Wilshire presented a draft of this analysis at the February 14, 2006 Investment Committee meeting and distributed a copy to interested parties for comment. Roz Hewsenian from Wilshire Associates will be available to present the analysis, discuss the comments, and answer the Committee's questions.

In addition, the Investment Committee Chair directed staff to report back regarding the possibility of investing in ADRs/GDRs (American Depositary Receipts and Global Depositary Receipts) from non-permissible equity markets that trade on the exchanges of permissible equity markets. The staff analysis for this request follows.

ADR/GDR Analysis

Depository Receipts are negotiable securities representing shares in a corporation that is not resident and does not operate in the country or countries in which the Depository Receipts are intended to trade. American Depositary Receipts are quoted and traded in U.S. dollars in the U.S. securities markets. Global Depositary Receipts may also be issued in US dollars and generally trade on European exchanges. Not all ADRs/GDRs are listed and traded on exchanges. For purposes of this report, staff is referencing "eligible ADRs/GDRs" by which we mean ADRs/GDRs that trade on a major exchange and are subject to certain registration, reporting and accounting requirements. Over-the-counter or private placement ADRs/GDRs would not qualify.

Based on Wilshire's draft permissible equity report for 2006, there are seven non-permissible equity markets remaining, with Indonesia moving to permitted status. Those markets are shown in the Table 1 below. Also shown in Table 1 is the number of stocks in the unconstrained FTSE benchmark for each non-permissible equity market. CalPERS' emerging markets managers are measured against a custom FTSE benchmark that eliminates the non-permissible countries and re-weights the remaining countries. Finally, Table 1 shows the number of eligible ADRs/GDRs in each of the non-permissible countries.

Note that Venezuela is not included in the unconstrained FTSE benchmark. It was removed from the index on June 23, 2003 due to the imposition of exchange controls. Sri Lanka, which would be in the cure period if the Investment Committee approves the recommendations in the 2006 Wilshire report, is not in the FTSE index either. Neither country has eligible ADRs/GDRs.

Table 1

Prohibited Market	Stocks in Unconstrained FTSE Benchmark	Eligible ADRs/GDRs
China	95	23
Colombia	8	2
Egypt	11	4
Morocco	6	0
Pakistan	9	0
Russia	11	9
Venezuela	0	0
Total	140	38

The number of ADRs/GDRs shown in Table 1 includes only those that trade on an eligible exchange (not over-the-counter) and excludes private placements and those instruments where there was no trading activity over the past two years.

Input from CalPERS' Emerging Markets Managers

Staff asked CalPERS' three emerging markets managers if they would invest in ADRs/GDRs from non-permissible markets that trade on the exchanges of permissible markets, assuming no change in their current benchmark. Two of the three managers indicated that they would, and collectively expressed interest in four markets: China, Egypt, Colombia and Russia. The two managers who would invest indicate that the exposure to these ADRs/GDRs likely would comprise from 4% to 5% of the portfolio they manage for CalPERS. These indications of interest could change as market conditions change.

Emerging Markets Company Reports

CalPERS' emerging markets managers provide annual reports to the Investment Committee on their screening of companies for CalPERS' nineteen geopolitical and investability factors, including compliance with the Global Sullivan Principles of Corporate Social Responsibility and the International Labor Organization Declaration on Fundamental Principles and Rights at Work. These reports will include ADRs/GDRs from non-permissible markets that trade on the exchanges of permissible markets, if the Investment Committee decides to permit investment in these instruments.

V. STRATEGIC PLAN:

This agenda item advances CalPERS Strategic Plan, Goal IV: Assure that sufficient funds are available, first, to pay benefits and second, to minimize and stabilize employer contributions.

VI. RESULTS/COSTS:

Changes to CalPERS' permissible equity market list will result in transaction costs. Staff will work to mitigate those costs by taking advantage of available crossing opportunities and transitioning the assets over a reasonable period of time.

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